

LENDING INSTITUTIONS IN BANKRUPTCY

Presently bankruptcy of financial institutions in Russia is primarily associated with cleaning of the banking sector evidenced by a steady growth of the number of banking licenses revoked by the Bank of Russia. Meanwhile, bankruptcy of financial institutions has its specifics in the form broad powers granted to the Central Bank which invokes special rules stipulated in Paragraph 4.1., Chapter IX, of the Federal Law dated October 26, 2002 No. 127-FZ ("On Insolvency (Bankruptcy)") (the "Bankruptcy Law") regulating the procedure of reorganization or liquidation of a financial institution.

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You Can't Make an Omelet Without Breaking Eggs

Reorganization in the banking area constitutes a set of measures aimed at restoring a financial institution's equity capital until the statutory capital adequacy ratio of equity is met, financial solvency, debt restructuring and streamlining bank management procedures.

Unlike other business entities, bankruptcy of prominent regional banks and core banks which operations are of vital importance to the system may result in destabilizing the financial system which determines the well-being of the economy in general, so the government if forced to undertake steps to maintain their stability in case a liquidity crisis arises (i.e. following the "too big to fail" principle). However, costs incurred in reorganizing such banks may many times exceed the costs for liquidating them.

Everything Old Is New Again Or?..

The first steps in relation to bank reorganization were taken in the 90s. In order to overcome the 1998 crisis and regulate measures on bank reorganization the Central Bank initiated the formation of the "Lending Institution Restructuring Agency" (the "LIRA") as an open joint stock company with the share capital of 10 bln rubles which further gained the status of a state owned corporation pursuant to Federal Law dated 08.07.1999 No. 144-FZ "On Restructuring Lending Institutions" (the "Law on Restructuring").

Before the enactment of the said Law, the principal method for bank restructuring was for LIRA to gain control over a bank by purchasing its controlling shareholding at a nominal price (e.g., one ruble) and then financing it. However, this was possible only if they managed to secure the consent of the bank's owners. The enactment of the above Law made it possible to restructure a bank on a compulsory basis regardless of the will of its shareholders by forcibly writing-off the bank's capital, if its capital actually held by shareholders turned out to be less than the authorized share capital or acquired a negative value.

Further reorganization involved the bank's recapitalization at the expense of the LIRA's funds, increase in authorized share capital, and compulsory conclusion of settlement agreements providing for transformation of the bank's outstanding obligations into new obligations, writing-off part of creditors' claims, deferring or extending the term for performance of the bank's obligations to creditors (actually a mechanism similar to "bail-in" was utilized). Later the provisions of the Law on Restructuring allowing for such settlement agreements were verified by the Constitutional Court and held as being in compliance with the Constitution of the Russian Federation (Resolution of the Constitutional Court of Russia dated 22.07.2002 No. 14-П). Following the completion of reorganization and restoration

of the bank's solvency, the LIRA withdrew from the bank's shareholding structure, and the bank was then auctioned to investors. In total, over the period of the LIRA's activities, 21 lending institution were reorganized.

In the meantime, such reorganization scheme was quite expensive, since the LIRA assumed all the burden of bad debts, and market mechanisms for bank reorganization were required. Another step to reform the banking sphere was enactment of the Federal Law dated 23.12.2003 No. 177-FZ "On Insurance of Individuals' Deposits in Russian banks" pursuant to which individuals' funds deposited in banks participating in the deposit insurance system are subject to reimbursement in the amount not exceeding 1.4 mln rubles upon occurrence of an insurance event: revocation (cancellation) the bank's license issued by the Central Bank for performance of banking operations or setting a moratorium on satisfying the bank's creditors' claims. Apparently, the bank's reorganization is beneficial, first, to an individual customer, since it allows preservation of his or her savings, considering that insurance payments if the bank is liquidated will be made only to individual customers, and legal entities and depositors which deposits exceed 1.4 mln rubles will be repaid on a priority basis stipulated by the Bankruptcy Law. Second, the market benefits as well, as this scheme prevents disorganizing the banking system where a core bank goes into bankruptcy and liquidation.

For the purpose of resolving issues related to payment of insurance indemnities, the Deposit Insurance Agency was formed (the "DIA") which later based on Federal Law dated 27.10.2008 No. 175-ФЗ "On Additional Measures to Strengthen the Stability of the Banking System in the Period by December 31, 2014" (the "Law No. 175-FZ") was for the first time engaged in financial recovery of banks having license to attract into deposits individuals' funds. Still, the legislator reserved the major role in banks' reorganization for the Central Bank by establishing pursuant to Article 189.47 of the Bankruptcy Law its right to propose the DIA's involvement in measures to prevent a bank's bankruptcy in the event of signs indicating its unstable financial situation threatening the interests of its creditors (depositors) and/or stability of the banking system. Besides, measures to prevent a bank's going into bankruptcy with the involvement of the DIA are implemented based on a plan approved by the Banking Supervision Committee with the Central Bank concerning the DIA participation in measures aimed at preventing such bank's bankruptcy. When the DIA is engaged pursuant to the Law No. 175-FZ, the following bank restructuring mechanisms were applied:

1 Attraction of a private investor to reorganize a bank. When this scheme was activated, the DIA searched for an investor (typically, an economically stable finance group) willing to assume the obligations to restore the solvency of the

reorganized bank and to invest its funds into its authorized share capital. In exchange, the DIA undertook to financially support such investor on condition of repayment, maturity and availability against interest payments through obtaining a special-purpose financing. Such credit facilities were most common.

2 Partial reorganization within which assets and obligations of the troubled bank were transferred to the reorganizer.

3 Acquisition by the DIA of shares (interest) in reorganized banks (at least 75%). This step tested through practice of bank reorganization in the period of the LIRA's activities was applied only in cases where investors refused to reorganize a troubled bank and its bankruptcy could not be allowed due to its federal or regional importance.

Generally, it is worth noting that financial recovery measures under Law No. 175-FZ were mostly limited to two options. In the first case, if an agreement was reached, shares (interest) in a troubled bank were transferred to an investor (or the DIA in the absence of the former) with their further sale. In the second case, measures on compulsory financial restructuring were taken by appointing a temporary administration with suspending the bank's management and writing-off the bank's capital to one ruble if the bank's equity capital was a negative figure. However, here the legislator already took into account the previous experience of granting such powers: unlike the Law on Restructuring, where this right was reserved to the LIRA, Law No. 175-FZ granted the right to write off the capital to the Central Bank, not the DIA.

Are There Any Risks for a Customer?

Thus, in the event of reorganization, the government to a greater or lesser extent assumes the burden of incurring the costs related to adding funds to the bank's capital. Consequently, its creditors, as a general rule, do not suffer (as opposed to when a bank is liquidated). Nonetheless, increased costs incurred to prevent lending institutions going into bankruptcy resulted in identifying ways to reduce them, one of which is shifting financial consequences both on a bank's owners and creditors of the reorganized bank, with the result that monetary claims of the bank's owners and creditors are either voluntarily or compulsorily written-off or converted into the share capital of the troubled bank. The «bail-in» mechanism was employed, in particular, when the Bank of Cyprus was reorganized in 2013, causing 47.5% of the amount of deposits exceeding 100 thous. euros were converted into the bank's shares, and the other part turned into long term deposits, i.e., virtually frozen. In Russia, similar mechanisms are allowed in relation to subordinated loans. Thus, for instance, pursuant to Paragraph 3.1.8.1.2 of the Regulation of the Bank of Russia dated 28.12.2012 No. 395-П, Article 25.1 of Federal Law dated 02.12.1990 No. 395-1 "On Banks and Banking Business", reduction of

capital adequacy ratio of equity of a lending institution below the level determined by the Central Bank serves as the grounds for termination (fully or partially) such lending institution's obligations for repayment of the principal amount of debt under a subordinated loan (deposit) agreement or under terms and conditions of a bonded loan in the amount required to reach the statutory capital adequacy ratio of equity. However, there is a milder option – the Central Bank may require a bank to exchange or convert creditor's subordinated claims and pecuniary sanctions related claims into the lending institution's ordinary shares. These schemes have successfully been implemented into practice (Resolution of the Moscow Region Arbitration Court dated 10.11.2016 No. Ф05-16440/2016 in Case No. А40-149813/2015; dated 02.11.2016 No. Ф05-16256/2016 in Case No. А40-132871/2015).

Weaknesses

Considering the fact that attracting an investor is the primary method of reorganizing a lending institution, one of the adverse consequences could be the risk of financial problems arising with the reorganizing investor. Thus, for example, when reorganizing the Bank of Moscow, the VTB bank based on the Government order dated 27.12.2014 No. 2739-p funds from the National Wealth Fund totaling 100 bln rubles were provided, on top of a subordinated loan by the Central Bank approximating 300 bln rubles. Another investor, Probiznesbank, acting as the reorganizer of Gaznegrobank, the Solidarnost bank, was declared by the Central Bank to be a bankrupt due to its liabilities exceeding its assets in the area of 70 bln rubles. In order to prevent similar situations from occurring in future, pursuant

to the Instructions of the Central Bank dated 29.04.2016 No. 4009-У, requirements imposed on reorganizing investors were toughened. Thus, in particular, an investor has to possess net assets of no less than 10% of the relevant bank's obligations, have positive aggregate financial performance results over the last four months, and an investing bank must comply with statutorily established capital adequacy ratio of equity for a lending institution over the last 3 years.

Specifics of reorganization is that the applicable mechanism is somewhat relaxed in terms of compliance with the standards established by the Central Bank, due to which investors are sometimes tempted to transfer their bad assets into the reorganized bank and utilize soft-term financing to resolve their insider the group problems and improve their financial standing.

Reforming the Reorganization Procedure

Meanwhile, the regulator is not satisfied with the current situation. At present, reorganizing insolvent banks is more costly than liquidating them.

For this reason, in order to reduce costs, raise the efficiency of control over the provided financing and to mitigate the dependence of financial recovery on an investor's financial standing, the Central Bank has initiated introduction of a new bank reorganization mechanism, in accordance to which investments will be made by the Central Bank independently through a specially formed Banking Sector Consolidation Fund and a management company directly into the capital of a reorganized bank in the amount required to ensure its proper capitalization and liquidity with further sale of shares of reorganized banks (Federal Law dated May 01, 2017 No. 84-FZ "On Amending Certain Enactments of the Russian Federation").

This means that a bank's capital will be restored immediately on account of the contribution made, hence, the reorganized bank will have to comply with the requirements set by the Central Bank. It is intended to reduce the interest in reorganization on the part of financially weak purchasers. Besides, for the purposes of financial recovery, the Central Bank at the expense of the said Fund will be entitled to grant subordinated loans (deposits) to reorganized banks, purchase and sell shares (interest in the capital) of reorganized banks, including at the price below the cost of their purchasing by the Central Bank. The main anticipated economic effect from introducing this reorganization mechanism is reducing the nominal financing by 30% and, subsequently, reducing the adverse impact of measures pertaining to banks' financial recovery on money demand and inflation rate. ↘

ПРЕСС-РЕЛИЗ

V МЕЖДУНАРОДНЫЙ ФОРУМ ВЕДУЩИХ ВУЗОВ «ГЛОБАЛЬНАЯ КОНКУРЕНТОСПОСОБНОСТЬ»

В Москве (отель «Рэдиссон Ройал») 7 июня состоится V Международный форум ведущих вузов «Глобальная конкурентоспособность», организатор – рейтинговое агентство RAEX («Эксперт РА»). В форуме примут участие представители профильных ведомств, руководители ведущих университетов России, члены международной ассоциации IREG Observatory, составители рейтингов, представители академического и экспертного сообщества, компаний – лучших работодателей – всего более 300 делегатов.

Основные темы для обсуждения:

- Три миссии: в поисках баланса между образованием, наукой и обществом.
- Как меняются приоритеты вузов в контексте глобальных вызовов, с точки зрения государства и самих университетов?
- Практический опыт повышения конкурентоспособности вузов.
- Российские вузы в рейтингах: реальность и ожидания.

На форуме состоится презентация шестого ежегодного рейтинга ведущих вузов России, а также рейтинга вузов по количеству выпускников в составе правления крупнейших компаний России (RAEX-600). RAEX («Эксперт РА») – первая в России и четвертая в мире организация, чьи рейтинги вузов успешно прошли международный аудит IREG Observatory – влиятельной ассоциации составителей и потребителей образовательных рейтингов.

По итогам рейтинга 100 лучших отечественных вузов в рамках форума запланирована церемония награждения высших учебных заведений и персонал, которые внесли значительный вклад в развитие образования в России.

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